THE REACQUISITION OF A NEGOTIABLE INSTRUMENT BY A PRIOR PARTY

The law of negotiable instruments is from one point of view well settled. The detailed rules applying to situations that ordinarily arise are with few exceptions undisputed. For this very reason, perhaps, the principles underlying those rules often remain uncertain because all that the judge or practical text-writer or draftsman of the Negotiable Instruments Law has to do is to state the rule of thumb. Some day, however, an unfamiliar situation occurs where banking precedents are few and inconsistent. Then the absence of a much worked-over background of theoretical doctrine has very serious results. The law of evidence was in a similar empirical stage until Thayer and Wigmore reasoned it out systematically; the law of negotiable instruments needs a like process. Meanwhile these abnormal states of fact in connection with commercial paper have a fascination far beyond their practical importance, for they elucidate the principles governing the normal situation, just as the behavior of a pigeon with a portion of its brain removed makes it easier to understand how an unmutilated bird flies straight.

This article proposes to apply such a method to a fairly common event in the circulation of negotiable paper, the reacquisition of an instrument by a person who has previously owned it or at least put his name upon it. For example, the payee of a note indorses and sells it, and after it has passed through three subsequent indorsers he buys it back. What is his consequent position? The usual explanation is that he gets his former rights, stands in his old shoes; that all the intermediate steps between his old and new possessions are blotted out. Of course this must be the result if he chooses to exercise his right of striking out his own indorsement and the subsequent indorsements.[1] This, however, is not obligatory; suppose he chooses not to do it. Is it then necessary to regard him as back in his old shoes? My purpose is to consider that explanation of his position, and also an alternative theory: that the reacquirer gets a fresh legal title like any other purchaser, although it may be that his former relations to the instrument affect his use of this new title.

[1] Negotiable Instruments Law (hereafter cited as N. I. L.) § 48: "The holder may at any time strike out any indorsement which is not necessary to his title. The indorser whose indorsement is struck out, and all indorsers subsequent to him, are thereby relieved from liability on the instrument." § 121 says that a secondary party who pays the instrument "*may* strike out his own and all subsequent indorsements, and again negotiate the instrument." See further discussion of § 121 in the body of the article. It will be noticed that § 48 is not limited to reacquisition, but would allow the purchaser of a note payable to bearer or indorsed in blank to strike out superfluous indorsements by persons whose liability he did not care to keep alive. The common law gave the same powers of striking out as the N. I. L. *Middleton* v. *Griffith* (1894) 57 N. J. L. 442, 31 Atl. 405.

If we confine ourselves to a normal situation, we shall be unable to decide between these two theories, because both will there produce the same result. Thus, in the case just supposed, the payee cannot sue the subsequent indorsers on either view. If the payee has merely his former rights, he never had any such rights against those who indorsed subsequently to his old ownership; their names are for all practical purposes stricken out. Yet, the payee will be no better off on the second theory, that his reacquisition gives him a fresh title, for if he sues the intermediate indorsers on their indorsements and secures judgments, any one of them on satisfying the judgment against him could obtain the note and turn around and sue the payee on *his* indorsement. We should be right back where we started. The law refuses to allow the payee to march it up the hill and down again, and denies him recovery in the first place to prevent circuity of action.[2] Therefore, in order to test these two theories some abnormal element must be introduced, after the fashion of the medical investigator. Without exhaustive collections of authorities, for a few cases will suffice to present the problems, the reacquirer will be placed in three infrequent situations, where the legal result will depend upon the theory that is adopted.

I

First, consider a reacquirer who could not have recovered from the maker in his original position, because he was then subject to an equitable defence, arising from the wrongful acts of a predecessor in title. For instance, A makes a note, payable to B's order; B obtains it by fraud; B indorses it to C, who is not an accomplice in the fraud, but has notice of it; C indorses to D, a holder in due course; finally, C reacquires the note from D, with D's indorsement. On the old shoes theory, C is remitted to his former rights and cannot recover; it is just as if the note had never passed through D's hands at all. What will be the effect of the other theory, which treats C as a purchaser?

It is a familiar principle that the purchaser from a holder in due course gets a perfect title, even if he himself be a purchaser with notice or after maturity or a donee. The law shelters these persons under the title of the holder in due course, not out of any love for them, but to give the meritorious holder all the incidents of full ownership, including the right to sell as well as the right to possess and sue.[3] Other kinds of property, such as land, are subject to the same principle, that a

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[2] *Bishop* v. *Hayward* (1791) T. R. 470; *Britten* v. *Webb* (1824) 2 B. & C. 483. N. I. L. § 50: "Where an instrument is negotiated back to a prior party, such party may, subject to the provisions of this act, reissue and further negotiate the same. But he is not entitled to enforce payment thereof against any intervening party to whom he was personally liable." See page 543, *infra*, for the possibility that "negotiated" means before maturity, in distinction from "paid" in § 121.

[3] *Chalmers* v. *Lanion* (1808) 1 Camp. 383; *Kost* v. *Bender* (1872) 25 Mich. 515, 54 L. R. A. 673 note; *contra, Bank of Willard* v. *Pennsylvania, etc. Co.* (1917) 175 Ky. 192, 194 S. W. 110, clearly wrong.

bona fide purchase for value without notice cuts off equitable interests. A different rule would, in Hardwicke's words,[4] "very much clog the sales of estates," for the victim of fraud by spreading notice of it could scare off prospective purchasers and force the innocent owner to keep his property or materially deteriorate its value: If C in our problem is a purchaser from D, shall he be similarly sheltered under D's innocence? If not, D's market, which the law is anxious to maintain, will be slightly restricted. However, the common law of negotiable instruments thought it better to cause this slight injury to D than to allow C to better himself by shooting title through a holder in due course.[5] The common law thus lends support to the old shoes theory. Nevertheless, the result may be explained on the other theory. Even if C has a fresh legal title, his conscience is still affected. He still knows that to collect would be aiding B's fraud, of which he was aware when he first bought the note.

Somewhat varying explanations of the difference btween C and other purchasers from a holder in due course are given in the cases. (1) Thus Chief Justice Bigelow of Massachusetts bases C's inability to recover from the maker on the doctrine of recoupment.[6] The maker would have a claim against C if the maker had been obliged to pay D, the holder in due course; for C's transfer to D cut off the maker's defence and thus did the maker a definite wrong.[7] Even if the defence is still cut off after C reacquires, the maker's tort claim against C must now be taken into consideration. This claim arose out of the same transaction as the note itself and hence is available by way of recoupment when C sues A. Whatever C recovers, A could get back, so C will be denied recovery to prevent circuity of action. This explanation is interesting for its recognition of the purchaser theory, but seems a needlessly complex application of it. A's right of action for cutting off equities is based on the existence of the equities, and they alone suffice

[4] *Lowther* v. *Carleton* (1741) 2 Atk. 242; see also *Harrison* v. *Forth* (1695) Prec. in Ch. 51; Ames, *Cases on Trusts* (2d ed. 1893) 286; Scott, *Cases on Trusts* (1919) 671, note.

[5] *Hatch* v. *Johnson Loan & Trust Co.* (C. C. 1895) 79 Fed. 828; *Webster & Co.* v. *Howe, etc. Co.* (1887) 54 Conn. 394; *Boit & McKenzie* v. *Whitehead* (1873) 50 Ga. 76; *Cline & Co.* v. *Templeton* (1880) 78 Ky. 550; *Sawyer* v. *Wiswell* (Mass. 1864) 9 All. 39; *Kost* v. *Bender* (1872) 25 Mich. 515; *Devlin* v. *Brady* (1867) 36 N. Y. 531; *Eckhert* v. *Ellis* (N. Y. 1882) 26 Hun 663, 665, (*semble*); *Brandhoefer* v. *Bain* (1895) 45 Neb. 781, 785, 64 N. W. 213; *Darst* v. *Brockway* (1842) 11 Ohio 462; *Tod* v. *Wick Bros. & Co.* (1881) 36 Ohio St. 370, 386, (*semble*); *Bute* v. *Williams* (Tex. Civ. App. 1913) 162 S. W. 989; *Hutchinson* v. *Munroe* (1850) 8 U. C. Q. B. 103. See *infra,* footnote 13, for cases under N. I. L.; also the cases in footnote 17.

[6] *Sawyer* v. *Wiswell* (Mass. 1864) 9 All. 39, 42; *Kost* v. *Bender* (1872) 25 Mich. 515, 517; *cf. Harrington* v. *Stratton* (Mass. 1839) 22 Pick 510, where the maker recouped against the payee for fraudulent representations with respect to the consideration, a chattel which was not returned.

[7] *Murray* v. *Burling* (N. Y. 1813) 10 Johns. 172; *Calkins* v. *Smith* (1872) 48 N. Y. 614, 618; *Nashville Lumber Co.* v. *Bank* (1895) 94 Tenn. 374, 29 S. W. 368, 27 L. R. A. 519, note.

to make it unconscientious for C to enforce his new legal title. It is unnecessary here to bring in recoupment. (2) Another explanation is that C committed one wrong in buying the note and a second wrong in selling it instead of returning it to A; the law will not allow him to profit from the second wrong.[8] This takes care of the situation when C is a buyer with notice but not when he takes after maturity or as a donee, for then he does not think of his sale to D as wrongful. (3) A third explanation[9] is that C's reacquisition may be a discharge of his liability as indorser, which is rightful, or it may be a purchase, which would be wrongful. As between these two interpretations of his action, the law, being charitably inclined, will adopt that which is entirely legitimate and refuse to impute an injurious purpose to C. Hence he will be regarded as a payor, not as a purchaser. This explanation faces two objections: it is contrary to the facts, and it accounts only for reacquisition by an indorser. Suppose the owner of a bearer note is subject to equities, sells it to a holder in due course, and reacquires it. He ought not to recover, although he cannot possibly be regarded as a payor.

A peculiar phrasing of the rule that a reacquirer cannot recover if he was originally subject to equities limits it to reacquisition by the payee. This narrow statement is found only by way of *dictum* or in text-books,[10] and there is no reason why an indorsee who is subject to equities should fare better than a payee, especially if the indorsee was an accomplice.

The sound explanation seems that the conscience-stained reacquirer of negotiable paper is just like a similar reacquirer of land or any other form of property. If a trustee of land sells it in breach of trust and then repurchases it, he would have a fresh legal title—the state of the record-books makes it impossible to say that he is merely back in his old shoes. But he still holds subject to the equity of the *cestui que trust,* whose interest has now revived.[11] Once a trustee, always a trustee. This principle applies through metamorphoses in the *res* and its ownership, and holds good of the constructive trusts in negotiable instruments which are wrongfully acquired. The purchaser theory, thus framed, is more consistent with the law of trusts than the old shoes theory, except in the few cases where a reacquirer (innocent or otherwise) actually intends only to discharge his indorser's liability, and not to purchase affirmative rights. It cannot be said, however, that any cases actually repudiate the old shoes theory, and in several it appears as a

[8] *Hoye* v. *Kalashian & Kazarian* (1900) 22 R. I. 101, 46 Atl. 271, under N. I. L.; *Kost* v. *Bender* (1872) 25 Mich. 515.

[9] *Berenson* v. *Conant* (1913) 214 Mass. 127, 101 N. E. 60; *Comstock* v. *Buckley* (1910) 141 Wis. 228, 124 N. W. 414; both under N. I. L.

[10] Daniel, *Negotiable Instruments* (6th ed. 1913) § 805; 54 L. R. A. 673; *Brandhoefer* v. *Bain* (1895) 45 Neb. 781, 64 N. W. 213; *Eckert* v. *Ellis* (N. Y. 1882) 26 Hun 663.

[11] *Bovey* v. *Smith* (1682) 1 Vern. 60; Scott, *Cases on Trusts* (1919) 671, note; *The W. B. Cole* (C. C. A. 1893) 59 Fed. 182, 187.

step in the reasoning, either alone or in combination with one or more of the reasons already mentioned.[12]

The Negotiable Instruments Law seriously complicates the problem, and may lead to results inconsistent with the old shoes theory. Section 58 provides in its second sentence:

"A holder who derives his title through a holder in due course, and who is not himself a party to any fraud or illegality affecting the instrument, has all the rights of such former holder in respect of all parties prior to the latter."

This takes care of a fraudulent payee, who takes back the instrument from a holder in due course, and also of any person, whether a holder or not, who is an accomplice of the defrauder; but how about the aforementioned C, who was not an accomplice but an indorsee with notice of the fraud? He could not recover before he transferred the note to a holder in due course, but the Act apparently permits him to recover after reacquisition, because he "is not himself a party to any fraud or illegality." If so, the Act surely treats him as a fresh purchaser, and not, by any means, as back in his old shoes.

Fortunately all the cases under the Act but one have avoided this unfortunate result, which would be a great encouragement to swindlers.[13] It is hard to see how the judges escape the implications of Section 58, but the point is little discussed. They seem to assume that the common law rule remains in force. One possible way out[14] is to regard a taker with notice of fraud as a "party" to the fraud, but this carries us altogether too far, for it would also deny shelter under the title of the *bona fide* purchaser to purchasers with notice who did not previously own the instrument. The defrauded maker could then ruin D's market by widespread advertising of the fraud. Unless we can say that C does not "derive his title" from D, but merely has his old title, Section 58 treats the reacquirer as a purchaser with a brand new legal title, absolutely free from equities, a result which even the advocates of the purchaser theory would deplore.

Some help may be gained from Section 121, which seems to adopt the old shoes theory:

"Where the instrument is paid by a party secondarily liable thereon,

[12] *E. g., Kost* v. *Bender* (1872) 25 Mich. 515; *Andrews* v. *Robertson* (1901) 111 Wis. 334, 87 N. W. 190, under the N. I. L.

[13] *Andrews* v. *Robertson, ibid.; Comstock* v. *Buckley* (1910) 141 Wis. 228, 124 N. W. 414; *Berenson* v. *Conant* (1913) 214 Mass. 127, 101 N. E. 60; *Hoye* v. *Kalashian & Kazarian* (1900) 22 R. I. 101, 46 Atl. 271; *Aragon Coffee Co.* v. *Rogers* (1906) 105 Va. 51, 52 S. E. 843; *Miller* v. *Chinn* (Mo. App. 1917) 195 S. W. 552; *Battersbee* v. *Calkins* (1901) 128 Mich. 569, 87 N. W. 760; *contra, Horan* v. *Mason* (1910) 141 App. Div. 89, 125 N. Y. Supp. 668, resting partly on absence of any proved defence, and adversely criticised by Brannan, *The Negotiable Instruments Law* (3d ed. 1919) 207, and Norton, *Bills and Notes* (4th ed. 1914) 454, note.

[14] Greeley, *The Uniform Negotiable Instruments Law in the Light of Recent Criticism* (1915) 10 Illinois Law Rev. 265, 271.

it is not discharged; but the party so paying it is *remitted to his former rights* as regards all prior parties, and he may strike out his own and all subsequent indorsements and again negotiate the instrument, except:—

1. Where it is payable to the order of a third person, and has been paid by the drawer; and

2. Where it was made or accepted for accommodation, and has been paid by the party accommodated."

This does not take care, however, of the owner of an instrument payable to bearer or indorsed in blank, who sells it to get rid of an equitable defense without having to indorse it, and then reacquires it from a holder in due course. He is not "a party secondarily liable." It is also possible that an indorser who reacquires before maturity does not *pay* the instrument, since payment in due course must be at or after maturity.[15] Therefore, where Section 121 does not apply, Section 58 may make possible a situation which is undesirable under the purchaser theory and absolutely inconsistent with the old shoes theory.

Let us return to the common law for certain other cases which afford good tests of the two views.

1. Thus far we have considered a reacquirer who had notice of the payee's fraud. Suppose instead a donee from the payee. Originally he could not recover from the maker. This innocent donee, having no notice of the fraud, indorses the paper to a holder in due course for two-thirds of its face-value. At maturity he is forced to take it up at face. If this donee is "remitted to his former rights" he still recovers nothing. If, however, he is considered as a purchaser, he gets one-third of the face-value, by the following reasoning. First, he now holds under a *bona fide* purchaser for value before maturity. There is no indelible stain on his conscience to affect him in his present position, for he never knew of the fraud. Therefore it is not inequitable for him now to enforce the note against the maker. On the other hand, in his former position as a donee of a note obtained by fraud, he was under a duty to return it to the maker. When he sold the note to D, the same duty applied to the proceeds. This money, two-thirds of the face-value, he has not paid over, and consequently, when he sues the maker for the full face, he will be subject to a cross-claim for this two-thirds. The donee's recovery is limited to the difference, or one-third. This result is just; the donee neither profits nor loses by the transaction. There are no cases in point on negotiable paper, but several trust cases furnish a strong analogy in his behalf.[16] On the old shoes theory, the donee though innocent would be seriously out of pocket, and his situation might be equally bad under Section 121 of the Act, unless (as sug-

[15] Brannan, *loc. cit.; Some Necessary Amendments of the Negotiable Instruments Law* (1913) 26 Harvard Law Rev. 493, 502.

[16] *Robes* v. *Bent & Cock* (1599) Moo. 552; *Mast & Co.* v. *Henry* (1884) 65 Iowa 193, 21 N. W. 559; *Bonesteel* v. *Bonesteel* (1872) 30 Wis. 516; see *Holly* v. *Missionary Society* (1901) 180 U. S. 284, 21 Sup. Ct. 395; *Dixon* v. *Caldwell* (1864) 15 Ohio St. 412; Scott, *Cases on Trusts* (1919) 671 note, 535.

gested below) this may be interpreted to give him his former rights plus something more.

2. An important group of cases which are hard to explain on the purchaser theory denies recovery to a person who buys the paper from the reacquirer.[17] Thus, C, an indorsee with notice from a fraudulent payee, reacquires the note by indorsement from D, a holder in due course. C, realizing that he cannot recover himself, indorses the note to X, a *bona fide* purchaser for value after maturity with no actual knowledge of anything wrong, who has assured himself by investigation of the unimpeachable title of his predecessor, D. The cases all refuse to shelter X under D's title. This result is easily reached on the "former rights" theory. Everything goes back where it was when C owed the note before. D drops out of the line of title entirely, and is on a spur track, as it were. The title takes a fresh start from the reacquirer. X derives, not from D, but from C alone. Are these cases irreconcilable with the purchaser theory? Since that theory derives X's title through D, should not X be sheltered under D? Two replies are conceivable. (1) If X were a purchaser with notice, public policy would deny him recovery, for otherwise, C could cash in by the easy process of selling first to a holder in due course and then to anybody; it would be almost as bad as if C could recover himself. This being so, X though without actual notice of fraud, has its equivalent from the indorsements on the note, which show that he is dealing with a reacquirer. This puts him on inquiry as to the possibility of something wrong. Let us, however, vary the facts a little and avoid this element of notice of reacquisition. Suppose the note is payable to bearer without indorsements. X does not know C is a reacquirer in any way, and relies on D's sound title. Should not X be sheltered, or must we say that the passage of maturity has thrown on X the burden of inquiry as to the remote possibility that X's transferror may be a reacquirer?[18] (2) It may also be argued that X should not be sheltered in any event because the principle of shelter is for the benefit of the holder in due course and not for that of later purchasers after maturity, however innocent. Even D has no protection with respect to a reacquirer, and the shelter principle simply does not operate when D sells to him, no matter how much the facts mislead a subsequent purchaser like X into supposing that it has operated. X must ascertain at his peril whether a reacquirer intervenes between

[17] *The W. B. Cole* (C. C. A. 1893) 59 Fed. 182; *Weil* v. *Carswell* (1904) 119 Ga. 873, 47 S. E. 217; *Quinn* v. *Fuller* (Mass. 1851) 7 Cush. 224; *Booher* v. *Allen* (1900) 153 Mo. 613, 55 S. W. 238; *Lancey* v. *Clark* (1876) 64 N. Y. 209; *Cleary* v. *Dykeman* (N. Y. 1914) 162 App. Div. 897, under the N. I. L., (*semble*); *Steinberger* v. *Hittelman* (1915) 93 Misc. 105, 156 N. Y. Supp. 320, under the N. I. L.; *Elwell* v. *Tatum* (1894) 6 Tex. Civ. App. 397, 24 S. W. 71; *Comstock* v. *Buckley* (1910) 141 Wis. 228, 124 N. W. 414, under the N. I. L. The law is the same as to other kinds of property, *The W. B. Cole* (C. C. A. 1893) 59 Fed. 182, 187.

[18] No cases on this question have been found. I have been interested to find much support for X in discussion.

D and himself. This may be sound, but seems unduly harsh in its effect upon the circulation of bearer paper after maturity. The unknown intervention of one reacquirer who is subject to equities in the ownership of the overdue paper imposes the same equities upon every subsequent innocent purchaser for value.[19]

Another test of X's position is this. In the usual situation, where the note bears the indorsements of the various owners, can X hold D on D's indorsement? If D has wholly dropped out (as the old shoes theory seems to imply), D is not liable. Yet this is unjust to X and highly technical, for D has suffered no wrong and ought to stand behind the signature on which X naturally relied as one of the reasons for taking the note. However, if X can recover from D, D can take the note and turn around and hold the maker. This is practically the same as letting X hold the maker directly, contrafy to the authorities.[20] Enough has been said to indicate the difficulties of either theory in this resale situation.

3. A peculiar case of reacquisition is *McAyeal* v. *Gullett*.[21] An evidence statute retained the interest disqualification for a party whose adversary was an executor, legatee, *etc.* The payee of a note died and it was indorsed to a legatee by the executrix. The legatee transferred it, reacquired it, and sued. It was held that these transactions did not relieve the maker from his incompetency to testify, since the plaintiff sued as legatee. This is correct on any theory, since the reacquirer may if he wishes retake his old position and expressly did so here.

4. Another case cited in support of the old shoes theory is *McKinnon* v. *Armstrong*.[22] A bankrupt had accepted bills, which the Armstrongs held and indorsed away before the bankruptcy. After the bankruptcy the bills fell due and were taken up by the Armstrongs, who wished to set them off against their debt to the bankrupt. A person becoming a creditor after bankruptcy cannot obtain a set-off, for otherwise debtors to insolvents would rush around to buy up claims. This and other British cases allowed the set-off, because the reacquirer was "remitted to his former rights" as a creditor.[23] This resembles the evidence situation. The reacquirer, having had a contingent claim against the bankrupt throughout which has now become unconditional,

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[19] The person who sues upon the note need not have dealt with the reacquirer himself. So long as there has been no holder in due course subsequent to the reacquisition, all takers are subject to equities unless they may be sheltered under the title of the holder previous to the reacquisition. This is made impossible by the old shoes theory. For example, if a bearer note obtained by fraud goes through fifty holders in due course and then is bought after maturity by a prior holder subject to equities, all subsequent holders are affected. This is important if bank-notes can become overdue under N. I. L. § 53. Brannan, *The Negotiable Instruments Law* (3d ed. 1919) 177.

[20] *Supra*, footnote 17.

[21] *McAyeal* v. *Gullett* (1903) 202 Ill. 214, 66 N. E. 1048.

[22] *McKinnon* v. *Armstrong Bros & Co.* (H. L. Sc. 1877) L. R. 2 A. C. 531.

[23] *Collins* v. *Jones* (1830) 10 B. & C. 777, 782.

may stand in his old shoes if he wishes. It is not held that he *must* do so, or that he would be denied the rights of a purchaser should he prefer to elect those. Moreover, in the United States the indorser would probably not be allowed to step back to his old position for the sake of acquiring a set-off.[24]

5. The payee of a bill of exchange indorses it away. The indorsee presents it for acceptance, which is refused. No notice of dishonor is given to the drawer or the payee. The payee, in ignorance of the dishonor, reacquires the bill before maturity. Can he hold the drawer, whom he duly notifies of non-payment? He should recover on the purchaser theory, since a holder in due course is not affected by the unknown dishonor.[25] On the "former rights" theory, recovery might perhaps be allowed, because the payee was subject to no defense before he sold, but his position is precarious, on the authorities. The cases are unsatisfactory, turning largely on the pleadings.[26]

Thus the authorities are by no means harmonious on the effect of reacquisition of paper subject to equities, especially in their interpretation of the Negotiable Instruments Law. Another problem will reveal even wider disagreements.

II

A person who puts his name on a negotiable instrument merely as a surety for some other party has not at that time any rights upon the instrument. Afterwards, he becomes owner of the paper by the payment of value. If he is a purchaser with a fresh title, he should be able to recover on the instrument from the person whom he accommodated. Of course, he has an independent action against his principal for reimbursement like any other surety who satisfies the creditor, but an action on the instrument may be more desirable, for his case is easier to prove if he has only to put in the note. Besides, the statute of limitations is longer in some states for commercial paper than for simple contract debts and the note may carry attorney's fees and similar advantages. Moreover, if there are any parties on the instrument prior

[24] *Newport Bank* v. *Herkimer Bank* (1912) 225 U. S. 178, 186, 32 Sup. Ct. 633, 636, (*semble*).

[25] *Dunn* v. *O'Keefe* (1816) 5 M. & S. 282; N. I. L. § 117.

[26] *Roscow* v. *Hardy* (1810) 12 East 434, reacquisition after maturity; see *Dunn* v. *O'Keefe* (1816) 5 M. & S. 282; *Bartlett* v. *Benson* (1845) 14 M. & W. *733. If the indorser cannot sue the drawer, he should be able to recover the money paid on reacquisition to the negligent indorsee, since it was paid under a mistake of fact in supposing that the indorser was liable to him although he was in fact discharged by the discharge of the drawer, and by the want of notice to himself. If the indorser paid the negligent indorsee after maturity, he is probably put on inquiry of unknown equitable defences and so unable to hold the drawer, unless we say that negotiable paper may travel backward when overdue without arousing suspicion in a prior party and so does not subject him to equities which have arisen since his former connection with the instrument. If the bill after dishonor by non-acceptance has been in the hands of an ordinary holder in due course, the indorser on reacquiring ought to be sheltered from the drawers equity of want of notice of dishonor by non-acceptance.

to the accommodated person, the reacquirer will be able to hold them if he is treated as a purchaser and allowed to sue on the instrument. His right of reimbursement does not affect them, and it would require a roundabout process of equitable execution for the surety to reach the liability of these parties prior to his principal on the theory that it is an asset of the principal. For example, if an indorser for the accommodation of the payee takes up a note, he ought in justice to be able to sue both the payee and the maker on the note, besides having a simple contract right against the payee on his implied promise to hold the surety harmless. He ought to be subrogated to the rights of the person he pays as well as reimbursed by his principal. The indorsee may do all this if he is a purchaser, but he has only the simple contract action if he is limited to his former rights.

The common law, despite its inclination to apply the old shoes theory to the situations previously discussed, treated this class of reacquirer as a purchaser. Whether he was a person in the chain of title who, however, was there merely for the purpose of indorsing for accommodation,[27] or an irregular indorser out of the chain of title who signed to back the payee or a later owner,[28] or an anomalous indorser, who signed so as to be liable to the payee,[29] he had all the rights of the holder in due course whom he had paid. The existence of equitable defenses against the surety's principal was no defense against him if he was without notice when he indorsed.[30] It was only when the surety signed as co-maker with his principal, or put his name on the back of a note in some state like Massachusetts that regarded the anomalous indorser as a maker and not an indorser,[31] that the reacquiring surety was not allowed at common law to sue upon the instrument. Such reacquisition by an express or constructive primary party is a special situation to be treated by itself, inasmuch as payment by a primary party extinguishes the instrument. It should not affect reacquisition by an accommodating secondary party, payment by whom, it is well settled, does not extinguish the instrument. The common law considered him a purchaser, for his right of action on the instrument was clearly inconsistent with the old shoes theory.

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[27] *Pinney* v. *McGregory* (1869) 102 Mass. 186; *Moynihan* v. *McKeon* (1896) 16 Misc. 343, 38 N. Y. Supp. 61.

[28] *Andrews* v. *Meadow* (1901) 133 Ala. 442, 31 So. 971; *Breckenridge* v. *Lewis* (1892) 84 Me. 349, 24 Atl. 864; *Reinhart* v. *Schall* (1888) 69 Md. 352, 16 Atl. 126; *Barker* v. *Parker* (Mass. 1858) 10 Gray 339; *Shaw* v. *Knox* (1867) 98 Mass. 214; *Beckwith* v. *Webber* (1889) 78 Mich. 390, 44 N. W. 330; *Laubach* v. *Pursell* (1872) 35 N. J. L. 434; *Flint* v. *Schomberg* (N. Y. 1858) 1 Hilt. 532; *Sheahan* v. *Davis* (1895) 27 Ore. 278, 40 Pac. 405; *Robertson* v. *Williams* (Va. 1816) 5 Munf. 381.

[29] *Hoffman* v. *Butler* (1885) 105 Ind. 371, 4 N. E. 681; *Fenn* v. *Dugdale* (1867) 40 Mo. 63; *Heaton* v. *Dickson* (1910) 153 Mo. App. 312, 133 S. W. 159; *Blanchard* v. *Blanchard* (1911) 201 N. Y. 134, 139, 94 N. E. 630, (*semble*).

[30] Instances are the last five cases in footnote 28.

[31] *Pray* v. *Maine* (Mass. 1851) 7 Cush. 253; see *Heaton* v. *Dickson* (1910) 153 Mo. App. 312, 133 S. W. 159. For actual co-maker cases, see *infra*, footnote 44.

That theory, nevertheless, seems to be adopted by Section 121 of the Negotiable Instruments Law, already quoted,[32] which remits the secondary party paying the instrument to his "former rights." If he had none before, he has none now. Such, at least, is the construction placed upon this section by the Massachusetts court.[33] Possibly this denial of recovery would be limited to an anomalous indorser. Two cases allow an irregular indorser who had backed the payee to hold the maker,[34] and one of these repudiates the Massachusetts view and would evidently give the anomalous indorser his common law rights on the note against the maker.[35] Various arguments are used for thus escaping the effect of Section 121. (1) It is said that this section applies only to those who had former rights, but the accommodation indorser had none at all. This argument would also permit an indorsee who had notice of fraud to reacquire the note and hold the maker, for he too had no former rights which could be enforced. The only possible distinction is that he had a legal title subject to equities, which might be considered as a "former right." Since the Act wholly refuses to deal with either legal or equitable interests by name or to make any distinction between them, but merely talks about "defects of title," a Scotch phrase borrowed from the British Bills of Exchange Act,[36] it can hardly regard the unenforceable legal title of the indorsee as amounting to a "right." (2) It is argued[37] that Section 121 applies only to a party secondarily liable who has himself been connected with the title to the instrument. This seems reasonable; the reacquisition might be regarded in his case as the rescission of his sale of the instrument, whereas the accommodation indorser has not sold and so cannot rescind. It is hard, however, to find any such limitation in the language of the section, which apparently embraces all secondary parties. Moreover, this idea of rescission would work unjust results in the third class of cases considered in this article. (3) It is suggested that Section 121 applies only to cases where the indorser has "paid" the instrument, and that payments come at or after maturity. If he takes up the instrument before maturity, this is a purchase, and he is not remitted to his former position. Section 50 applies to such cases; the paper is not "paid" but "negotiated back." This distinction is fruitless. It would allow an indorsee subject to notice of fraud to reacquire and enforce a note against a defrauded

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[32] Page 542, supra.

[33] *Quimby* v. *Varnum* (1906) 190 Mass. 211, 76 N. E. 671. This case was somewhat influenced by *Pray* v. *Maine* (Mass. 1851) 7 Cush. 253, and also by the absence of any indorsement from the payee to the anomalous indorser.

[34] *Lill* v. *Gleason* (1914) 92 Kan. 754, 142 Pac. 287; *Graves* v. *Neeves* (1913) 183 Ill. App. 235. See *Noble* v. *Beeman-Spaulding-Woodward Co.* (1913) 65 Ore. 93, 131 Pac. 1006.

[35] *Lill* v. *Gleason* (1914) 92 Kan. 754, 142 Pac. 287.

[36] Lindley, J., in *Alcock* v. *Smith* [1892] 1 Ch. 238.

[37] *Lill* v. *Gleason* (1914) 92 Kan. 754, 142 Pac. 287.

maker, so long as the reacquisition was before maturity. It would bar the innocent accommodation indorser who is forced to pay the note after maturity to avoid suit or execution. Why should he be worse off than if he had voluntarily bought the paper before maturity? The common law made no such distinction, but allowed him to recover regardless of the time of reacquisition. An attempt to establish this distinction between purchase and payment was definitely checked by Chief Justice Shaw.[38] (4) The best way out is to treat Section 121 as not exhaustive. The reacquirer has his former rights *plus* whatever additional rights he is entitled to by the law merchant, whether specified in the Act or not. Unless the word "remitted" is to be taken in the sense of limited, restricted, this interpretation is sound and makes it possible to solve the various problems on principle.

Some special questions under this heading require attention.

1. The surety indorser on paying has, we have seen ,two rights against his principal unless hindered by the literal wording of the Act: a right on the note either as purchaser or by way of subrogation to the position of the paid holder; and an independent right to reimbursement. The statute of limitations begins to run on the note at maturity, and on the independent right at the time the surety pays. Consequently, if he takes up the note after maturity, and the statutory period for both rights is six years, the right of reimbursement will remain available after an action on the note is barred.[39]

2. If two indorsers are co-sureties and one pays the whole instrument, he should have two rights of contribution against his co-surety, one on the instrument and the other on an implied promise to share the loss. The authorities have not fully recognized the first of these rights.[40]

3. If the accommodation indorser reacquires the note for less than

[38] *Ellsworth* v. *Brewer* (Mass. 1831) 11 Pick. 316, 320, allowing an indorser to take up the note after maturity though not duly notified, and hold a prior indorser who was duly notified: "We have used the expression 'taking up the note,' to avoid any inference to be drawn from the use of the term 'payment' . . . There are some cases, no doubt, where the distinction between a payment which discharges a contract, and a purchase, which implies a continuance of it in force, is material, as in case of a mortgage. But a different rule applies to the indorser of a bill of exchange or promissory note. As between himself and the holder, it may be deemed a payment and would extinguish the contract created by that particular indorsement, but would not affect the validity of the instrument, as a subsisting security as to prior parties." The rest of the opinion has expressions which would alternately support the reinstatement and the purchaser theories.

[39] *Blanchard* v. *Blanchard* (1911) 201 N. Y. 134, 94 N. E. 630; see *Hurlbut* v. *Quigley* (1919) 180 Cal. 265, 180 Pac. 613; 2 Williston, *Contracts* (1920) § 1283, note 86.

[40] *Gregg* v. *Carrol* (1919) 201 Mo. App. 473, 211 S. W. 914, denying the benefit of the longer statute of limitations applicable to an action on the note; *Miller* v. *Del Rio, etc., Co.* (1913) 25 Idaho 83, 136 Pac. 448, both under N. I. L.; but the contrary and sound result is reached in *Lidderdale* v. *Robinson* (U. S. 1827) 2 Brock. 159, 12 Wheat. 594, subrogating a coindorser to the holder's statutory prior claim in insolvency.

its face value, how much can he recover from the accommodated maker? The old shoes theory denies him anything on the note; will the purchaser theory give him the whole face-value like any other indorsee? Some cases allow this,[41]—a result of course wholly at variance with any remission to his former rights,—but the better view is that he recovers just what the note cost him whether he sues on the note or on his independent right of reimbursement.[42] As in the cases where the reacquirer was subject to equities before, his conscience cannot be cleared by the sale and purchase. Once a surety, always a surety. He must not speculate and gain a profit at the expense of his principal. He should not object to the fact that his reacquisition has brought a windfall to the principal, who would have been liable for the full face if sued by any one but the surety. All the indorser can ask is to come out whole; beyond that he acts for the benefit of his principal. Here again, it has been suggested that it makes a difference whether he takes before or after maturity; if before, he is said to be a purchaser not a payor, and therefore he can recover the full face. I can see equally good reasons for just the opposite distinction: the accommodation party who is obliged to assume the doubtful chance of reimbursement from the accommodated maker ought to get some compensation for the risk which is forced upon him; not so if he willingly takes over the note before maturity. Here again it is a mistake to distinguish between purchase and payment. Time should make no difference.

4. If a person who has signed the instrument as a guarantor and not as an indorser takes it up, he should be treated like a purchaser and not remitted to his non-existent former rights.[43] Section 121 of the Negotiable Instruments Law should not prevent his recovery on the note, since he is not a secondary party or really a party at all.

5. If the surety who reacquires a note is a co-maker with his principal, it is much harder to let him sue on the note, though of course he has his independent action for reimbursement. On principle, he should at least be allowed to sue on the note in the name of the holder whom he paid. He is subrogated to that creditor's rights to any securities annexed to the obligation, and ought also to have the benefit of the obligation itself. The difficulty is that payment by a primary party extinguishes a note both by the law merchant and under Section 119 of the Act. However, equity should keep the obli-

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[41] *Fowler* v. *Strickland* (1871) 107 Mass. 552.

[42] *Bethune* v. *McCrary* (1850) 8 Ga. 114; *Burton* v. *Slaughter* (Va. 1875) 26 Grat. 914. So as to specialties, *Reed* v. *Norris* (1837) 2 Myl. & C. 362, 374; *D. L. & W. R. R.* v. *Oxford Iron Co.* (1884) 38 N. J. Eq. 151. See 2 Williston, *Contracts* (1920) § 1285.

[43] *Noble* v. *Beeman-Spaulding-Woodward Co.* (1913) 65 Ore. 93, 131 Pac. 1006; *Leslie* v. *Compton* (1918) 103 Kan. 92, 172 Pac. 1015, annotated in L. R. A. 1918 F 709; both under N. I. L.

gation alive to prevent unjust enrichment of the principal at the expense of the surety, and give the latter every fair means to make himself whole. It is also proper to treat the surety for this purpose as a purchaser and allow him to sue at law in his own name on the note. In accordance with this view a recent decision under the Act allows the co-maker to recover both the face of the note and the attorney's fees stipulated therein, which would not be awarded in an independent action for reimbursement.[44]

The numerous situations considered under this heading make plain the injustice of a literal interpretation of Section 121 and of any view of the position of a reacquirer which insists upon always thrusting him back into the Procrustean bed of his former rights. Possibly justice will be achieved in these situations by a sort of middle theory. As a surety he may be entitled to subrogation and the right to sue on the instrument in the name of the person from whom he reacquired. There is much authority, however, for going farther and adopting the view that the reacquirer is a purchaser, entitled to enforce the paper in his own name. And the limited subrogation view will be of no help in the third and last problem, now to be discussed.

III

What are the rights of a purchaser from the reacquirer in cases where the reacquirer was subject to no equities? Can such a purchaser recover from intermediate indorsers, who signed after the reacquirer's original holding and before his reacquisition? It is clear that the reacquirer himself could not have held these intermediate indorsers on any theory. For example, A makes a note payable to B, who indorses to C, who indorses back to the maker. Obviously, A cannot hold B or C as indorsers on the reinstatement theory, for a maker cannot sue on the note at all; and he cannot hold them on the purchaser theory, because of the circuity of action involved by their turning around and suing him as maker. But suppose A indorses the note to X for value and before maturity. On the old shoes theory the title takes a fresh start and X has no rights except possibly against A. If, however, the maker can be regarded as a purchaser, X's prospects are much brighter. Clearly, if a holder had no means of knowing of the maker's reacquisition, he ought to recover from the indorsers. Suppose, for instance, that C had indorsed in blank, that A had not indorsed at all, that A sold to

[44] *Pease* v. *Syler* (1914) 78 Wash. 24, 138 Pac. 310, under N. I. L. The reasoning that the co-maker is "a party secondarily liable" under § 121 is very questionable, in view of § 192, but the case rests on sound principle as well. *Accord. Rockingham Bank* v. *Claggett* (1854) 29 N. H. 292; *Kipp* v. *McChesney* (1872) 66 Ill. 460; *contra, Stevens* v. *Hannan* (1891) 86 Mich. 305, 48 N. W. 951, and cases *supra.* footnotes 31, 33; see *Dillenbeck* v. *Dygert* (1884) 97 N. Y. 303; *Conrad* v. *Smith* (1895) 91 Va. 292, 21 S. E. 501. That subrogation exists on general principles: *Hodgson* v. *Shaw* (1834) 3 Myl. & K. 183; *Truss* v. *Miller* (1897) 116 Ala. 494. 22 So. 863; 2 Williston, *Contracts* (1920) § 1268.

R who sold to S, and that S was ignorant that the note had ever been in the maker's hands since it was originally issued. There is nothing on the paper to give him warning, and he relies on the credit of the indorsers. To deny him recovery would be to subject a holder in due course to technical and unforeseeable defences. He certainly should not be affected by the defence of circuity of action, though good against the maker, unless he had notice of its existence. Does it make any difference that X, in the case first supposed, did know of the circuity of action or should have inferred it from the course of the special indorsements back to the maker? Why is it unjust to require the indorsers to pay X? They have suffered no wrong whatever. The maker did not injure them by reacquiring before maturity or by putting the note into circulation again, for until it is due they have no right to insist that he pay and keep it. True, A could not sue on the note himself, but circuity of action is not an equity. It is merely a personal and temporary defence, very different from fraud. Like accommodatoin, it bars him; but should not bar transferees for value before maturity, even with notice. After maturity, it is entirely different. The maker, having paid the note, has a duty to keep it. The indorsers cannot justly be asked to incur a renewed liability. Consequently, it is a wrong toward them for the maker to put an overdue note into circulation again, and all subsequent purchasers are subject to the defence. But the conscience of a person who buys the reacquired note before maturity is nowise tainted and he should not be barred against the indorsers, because it is entirely just for him to hold them.

The authorities are divided,[45] but many cases allow an acceptor of a maker who reacquires an honest instrument to pass it on before maturity to persons who can hold the indorsers. The same principle applies to an indorser who reacquires. He should not be forced to exercise his right of striking out subsequent indorsements if he prefers to retain them in order to obtain a better market for further circulation of the instrument.[46] The drawer ought to be allowed the same right of renegotiation, but Lord Mansfield's misunderstood decision in *Beck* v. *Robley*[47] has created an arbitrary rule that he cannot renegotiate a bill except when he is the payee. With this exception the law merchant runs strongly in favor of the purchaser view in this class of cases, but the wording of Section 121 of the Negotiable Instruments Law not only perpetuates the arbitrary drawer rule, but also seems to permit renegotiation by indorsers only on condition of striking out subsequent indorsements. The only way out of this unfortunate result is to regard

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[45] See the exhaustive note in L. R. A. 1918 E 170.

[46] *West Boston Savings Bank* v. *Thompson* (1878) 124 Mass. 506.

[47] (1788) 1 H. Bl. 89, note (a), an accommodation bill paid by the accommodated drawer at maturity; hence his renegotiation was improper. *Contra*, for value bills, *Drew* v. *Phelps* (1847) 18 N. H. 572; *Smith* v. *Bryan* (N. C. 1850) 11 Ired. 418. But see N. I. L. § 121 (1).

the section as permissive and not mandatory and exhaustive in its description of reacquisition by a secondary party. Reacquisition by a primary party before maturity is apparently not covered by the Act, since Section 50 merely makes circuity of action a defence as against the reacquirer himself. In several cases under the Act indorsers have been held, despite such reacquisition.[48]

Many other questions about reacquisition present serious difficulties. Is indorsement to the reacquirer essential? Can the reacquirer take up the instrument after maturity free from equities of which he has no notice and which have arisen since his former holding, or must he be treated like any other purchaser of overdue paper? These speculations await future discussion. And indeed many of the questions raised in this article have not been answered. Its main purpose was to show how the problem of reacquisition presents itself in diverse portions of the law of bills and notes, and how far we are from any consistent theory of the nature of the reacquirer's position. Some may say that no such theory should be sought, that harmony in legal principles is a will-of-the wisp, each specific rule having been worked out by itself in response to *mores,* economic pressure, and other non-legal factors. Yet, in spite of the atomistic character of much of the common law, I believe it is possible to unearth some structural principles and to build others. One such principle in the commercial law, though imperfectly realized, is this: a prior party or owner who reacquires an instrument is in some sense a purchaser, and is not merely remitted to his former rights. He may gain for himself and may confer upon his transferees new rights. Yet though he has a new legal title, he cannot destroy former equities. Despite his new shoes the old burrs still cling to his stockings.

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[48] See *supra,* footnote 45.